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Address Official Communication To
Office of the United States Political
Adviser for Japan,
Tokyo.

MEMORANDUM OF CONVERSATION

Subject: Informal Discussions on the United States Standard Draft Treaty of Friendship, Commerce and Navigation

Participants: For the Ministry of Foreign Affairs:

Mr. Morio YUKAWA, Director of the Bureau of Economic Affairs
Mr. Kenichi OTABE, Vice Director, Bureau of Economic Affairs
Mr. Haruki MORI, Chief, First Section, Bureau of Economic Affairs
Mr. Masao OSATO, Chief, Fourth Section, Treaty Bureau
Mr. Takeshi KANEMATSU, Secretary, First Section, Bureau of Economic Affairs
Mr. Kay MIYAGAWA, Secretary, First Section, Bureau of Economic Affairs

For the Office of the United States Public Adviser, Japan:

Mr. Jules BASSIN, Legal Attache
Mr. William W. DIEHL, Financial Attache
Mr. Dudley G. SINGER, Commercial Attache

Place: Office of the United States Political Adviser, Tokyo, Japan.

Date: Tuesday, March 4, 1952 FOURTH INFORMAL MEETING

ARTICLE VII

Mr. Otabe opened the meeting by proposing that Article VII of the standard draft be replaced by the following:

"1. Nationals and companies of either Party shall be accorded, within the territories of the other Party, national treatment and most-favored-nation treatment with respect to engaging in commercial, manufacturing, processing, construction, publishing, scientific, educational, religious and philanthropic activities.

"2. Nationals and companies of either Party shall be accorded, within the territories of the other Party, most-favored-nation treatment with respect to:

(a) exploring for and exploiting mineral deposits;

(b) engaging in fields of economic and cultural activity (except financial and insurance activity) in addition to those listed in paragraph 1 of the present Article or in subparagraph (a) of the present paragraph;

(c) organizing, participating in and operating companies of such other Party.

"3. Nationals and companies of either Party shall be accorded within the territories of the other Party the right to organize companies for engaging in commercial, manufacturing, processing, construction, mining, publishing, scientific, educational, religious and philanthropic activities, and to control and manage enterprises which they have been permitted to establish or acquire within such territories for the foregoing and other purposes.

"4. Companies, controlled by nationals and companies of either Party and constituted under the applicable laws and regulations within the territories of the other Party for engaging in the activities listed in paragraph 1 of the present Article, shall be accorded national treatment therein with respect to such activities."

In presenting the Japanese proposal, Mr. Otabe indicated that paragraphs 1 and 2 were the same as Article VII, paragraphs 1 and 2, of the U.S.-Colombia FCN Treaty except for the words "financial" and "professional", and that paragraphs 3 and 4 were the same as Article VIII, paragraphs 1 and 2 of the same Treaty. Mr. Otabe pointed out that the deletion of "professional activities" from the Japanese draft was made because it was covered in Article VIII of the standard draft.

Mr. Bassin asked whether Mr. Otabe desired to comment with respect to the deletion of "financial activities".

Mr. Otabe replied that in order to prevent the possibility of foreign control of the economy of a country, it was not desirable to extend national and most-favored-nation treatment to "financial activities". He said, with respect to the domestic activities of banks, that even the United States did not permit foreign banks to engage in domestic depository functions, for the probable reason of preventing control of domestic industries by such banks. In this regard, Mr. Otabe felt that the mere prohibition of a depository function would not be sufficient to prevent control of

domestic industries, since foreign banks could easily acquire capital from other sources or by the issuance of debentures. He also pointed out that since industry may be controlled by means of bank loans, Japan did not look with favor upon foreign investment loans to mining, gas, and electric industries. Furthermore, he noted that foreign banks through loans could acquire an intimate knowledge of the domestic industrial and economic situation which might, in some cases, be prejudicial to the national defense, although this comment was not directed towards the United States. From the point of view of protecting debenture holders, Mr. Otabe said foreign banks should not be permitted to issue debentures, since this activity also permitted foreign banks to acquire control of industry. Mr. Otabe added that it was not feasible to exercise adequate supervision of a bank whose main office was located abroad.

Turning to the international activities of banks, Mr. Otabe pointed out that in a country like Japan, where there is little capital and high interest rates, there is always the possibility that its exchange activities might be influenced and controlled by foreign banks which possess abundant capital and low interest rates. Moreover, he said, banks could even control foreign trade through their lending activities, and it was more difficult to control foreign banks in their exchange activities than Japanese banks.

Mr. Otabe then said that since insurance companies have the same characteristics as financial institutions, he did not believe that national treatment should be accorded insurance institutions for the reasons he had just given. With respect to most-favored-nation treatment, Mr. Otabe said that since conditions differ among the various countries, it was not desirable to accord such treatment to financial and insurance activities. In concluding his remarks, Mr. Otabe pointed out that the views presented concerning financial activities were advocated and urged by the Ministry of Finance.

In reply to Mr. Otabe's general remarks, Mr. Singer stated that the first paragraph of Article VII can be considered the heart of the treaty; it is the basic "establishment" provision, prescribing the fundamental principle governing the doing of business and the making of investments, in a treaty which is, above all, a treaty of establishment. He stated that a satisfactory formulation of this paragraph, and its corollary provisions in the remainder of the Article, is therefore of particular importance and to be approached with special care. He further stated that the new standard formulation of Article VII (and its companion, VIII) as proposed to Japan has already appeared in the treaty with Isreal, but was developed too recently for use in the negotiations leading to the other treaties hitherto concluded by the United States. He said that its inclusion in a treaty with Japan would not, therefore, be unprecedented, as might be supposed. He said the formulation proposed to Japan is considered to be more precise than that formally in use (as appearing in the Colombia Treaty) and it is not believed that the substitution of the Colombia Treaty wording would meet the desire for greater precision.

Mr. Singer further stated that while the formulation as found in the Colombian Treaty has been much used, it was subject to certain difficulties because the use of the recitative phrase "commercial, manufacturing,..." for describing activities covered by the national treatment rule was susceptible to a wide interpretation as to what businesses were and were not covered, and the residual rule applicable to activities not covered by national treatment was not as adequate as might be desired. To remove or reduce such difficulties, Mr. Singer said the new standard formulation first stipulates the principle of sweeping coverage for all business activities of every type as is found in paragraph 1, and then indicates in paragraph 2 the exceptions in a precise manner so as to define what may not be subject to national treatment. Mr. Bassin pointed out, in support of Mr. Singer's remarks, that it would be preferable to use the technique as indicated in the standard draft, and thereafter to consider those activities to be excepted, for inclusion in paragraph 2. By this device, for example, if it were agreed to except "financial activities" or certain aspects thereof, from national and most-favored-nation treatment, then such activities could be defined and listed in paragraph 2.

Returning to the specific point concerning "financial activities", Mr. Bassin pointed out that paragraph 2 permits each party to limit activities in "banking involving depository or fiduciary functions" and therefore that such reservations would appear in general to meet the Japanese view concerning banking activities.

Mr. Otabe inquired as to the meaning of "fiduciary functions". Mr. Bassin said that although the term is very broad, it contemplates a relationship where a person places a trust in or relies upon another. He added that it is a relationship between two persons in regard to a business, contract, or piece of property, or in regard to a general business or estate of one of them, of such character that each must repose trust and confidence in the other. Mr. Bassin said examples of a "fiduciary function" were the relationship existing between an attorney and client, guardian and ward, principal and agent, executor and heir, or landlord and tenant. Mr. Bassin said that if the bank performed a function such as guardian of a minor, trustee of an estate, or executor of a will, such activity would be a fiduciary function under the terms of Article VII, paragraph 2.

Mr. Otabe inquired whether the relationship of creditor and debtor constituted a fiduciary relationship. In reply, Mr. Bassin said that a creditor-debtor relationship was not within the scope of a fiduciary activity of a bank.

At this point, Dr. Diehl stated that the Ministry of Finance's proposed deletion of "financial activities" from protection of the Treaty might be misinterpreted, since on the one hand the Japanese Government was desirous of obtaining American capital and investment in Japan, whereas on the other hand it was not willing to grant assurances that treaty protection would be available. He said that the Ministry of Finance's position would create a serious problem in providing suitable protection for banking and insurance interests, and that such interests

would be justified in taking under advisement any plans for substantial investments in Japan. Dr. Diehl felt that the proposed deletion would affect not only the heart of the treaty, but create problems which might not readily be resolved.

Dr. Diehl remarked that although reasonable Japanese requirements would be entertained in a spirit of accomodating special local circumstances where the need was clear, it appeared that the instant proposal to delete "financial activities" would appear to impair the integrity of the treaty. Mr. Bassin added that he doubted whether the Department of State would be inclined to favorably entertain a proposal as fundamental as the one being advocated and urged by the Ministry of Finance.

Mr. Yukawa stated that he would consider this question in the light of the remarks made by the American side, and would confer again with the Ministry of Finance.

Mr. Mori stated that the Japanese side desired to amend Article VII, paragraph 1, either by deleting the phrase "other activity for profit", or by adding to such phrase the qualification that such "other activity for profit" contribute to the economic rehabilitation of Japan. The object of such amendment, Mr. Mori explained, was to prevent American business interests from receiving the protection of the treaty where their profit-seeking activities did not contribute to Japan's economy, and at the same time tended to create pressures affecting Japan's external payments position. As an illustration of his point, Mr. Mori cited the U.S. motion picture interests in Japan, which have accumulated large yen earnings and are now seeking either foreign exchange remittances or other suitable outlets for their holdings, without a comparable beneficial contribution to the Japanese economy. Mr. Mori said that although American motion pictures were desirable from an entertainment point of view, they were not, in his opinion, helping the Japanese economy. He suggested that Japan should have complete freedom of action in the field of business and financial activities.

Mr. Bassin said that the inclusion of restrictive language as suggested by Mr. Mori would not grant the clarity and definity desired in a matter of utmost importance. He stated that business circles in the United States and Japan would be in doubt as to whether national or most-favored-nation treatment was applicable in a given business activity, at any given time. He added that Article VII, paragraph 1, is a statement of general principle, and should not contain restrictive clauses.

Mr. Yukawa asked whether the clause "commercial, manufacturing,... processing" in Article VII, paragraph 1 of the Japanese proposal covered the following: real estate brokerage, stock brokerage, warehousing, motion picture production, tourist industry, hotel services, broadcasting, canning of fish products, repairing, mixing, assembling, lumbering, freight forwarding, and stevedoring. Mr. Bassin stated that these activities, except broadcasting, and with the possible exception of lumbering, could

be considered to fall within one or another of the activities generalized in Article VII, paragraph 1 of the Japanese draft. He added that broadcasting was connected with communications, reserved under the treaty, and that lumbering, if this term included the cutting of timber, would be regarded as exploitation of natural resources, also reserved. If lumbering did not include such exploitation of timber lands it would be regarded as a commercial or processing activity.

Mr. Yukawa inquired as to whether Article VII, paragraph 3, of the Japanese proposal would permit a country to impose restrictions on alien ownership of particular types of activities which are necessary in the public interest and national economy. Mr. Bassin said that the term "public interest and national economy" was vague and indefinite but that Article IX, paragraph 4, of the standard draft would indicate that reasonable restrictions on alien activities could be based in the interests of public safety, as well as in connection with certain types of activities as mentioned in Article VII, paragraph 2.

Mr. Yukawa inquired whether his understanding was correct that each party may exercise necessary control under the treaty over entry of capital incident to the business activities of aliens so as to safeguard its external financial position or balance of payments. Mr. Bassin said that this problem concerned foreign exchange controls, and with Mr. Yukawa's permission, suggested that the question be raised under Article XII. However, Mr. Bassin said, any unreasonable restrictions on the entry of capital necessary for the permitted business activities of aliens could be interpreted as an interference with Article VII, paragraph 1, which provides that nationals and companies be permitted to control and manage enterprises which they have established or acquired.

Mr. Yukawa stated that aliens in Japan are required to deposit greater security than is required of Japanese nationals in certain types of activities. He then inquired as to whether this requirement would violate the principles of national treatment in respect to engaging in such activities. Mr. Bassin indicated that if the activities fell within Article VII, paragraph 1, such requirement would violate the national treatment principle, but if the activity came under paragraph 2, it would not. However, he added, the provisions of Article VII, paragraph 3, permit either party to prescribe special formalities in connection with alien-controlled enterprises, and such formalities might conceivably include security deposits, provided they did not impair the substance of the rights set forth in Article VII, paragraph 1, of the standard draft.

Mr. Yukawa stated that the Japanese side desired to restrict alien activities in the shipbuilding industry. He cited the case of National Bulk Carriers, Inc. (N.B.C.), a United States corporation, presently under contract with the Japanese Government to construct or repair vessels "for the use of N.B.C." at Japanese shipyards in Kure, Japan. Mr. Yukawa asked whether the treaty would require that N.B.C. be given national treatment and thus enable it to undertake construction or repair of vessels "for others", as may Japanese shipbuilding companies. Mr. Bassin

replied that N.B.C., by contract with the Japanese Government, is limited to a certain type of activity and that the treaty would not require an amendment of such contract to permit national treatment. Mr. Bassin said that if N.B.C. desired to widen its scale of operations to national treatment, then it would have to amend the contract, which would leave the Japanese Government free to reconsider the matter.

Mr. Yukawa asked whether it would be necessary to accord shipbuilding subsidies to alien companies engaged in shipbuilding under the national treatment principle, if such subsidies were available only to nationals. Mr. Yukawa said that in the United States a construction-differential subsidy to aid in the construction of vessels to be used in the foreign commerce of the United States is granted only to citizens of the United States. Mr. Bassin said that he did not understand that the treaty required a government to grant a subsidy for ship construction to aliens. He said that a subsidy was in the nature of a grant from a government for a specific purpose and that it was normal for the government making the grant to limit the recipients to those who are citizens of the country. Mr. Bassin said that in the shipbuilding industry the national treatment principle would be met if alien companies were given the same opportunity as nationals to engage in shipbuilding, and that any question of subsidies was a matter between the national and his government.

Mr. Yukawa said that those activities related to the manufacture and distribution of electricty and gas should be excluded from the protection of the treaty because of the public character of the activity concerned. Mr. Singer replied that he doubted whether any American capital in this field would enter Japan without the assurances of a treaty provision protecting their interests.

Mr. Singer summarized the Japanese position on Article VII as follows: the Japanese side did not desire to accord national and most-favored-nation treatment to financial, insurance, gas and electric, and shipbuilding activities; that they desired to be free to impose restrictions on alien ownership necessary in the public interests and economy; that they desired to control the inflow of capital investment incidential to the business activities of aliens; and that in certain types of activities aliens should not receive national treatment with regard to deposits of security.

It was agreed that the next meeting would be held on Friday, March 7, 1952.

/s/ M. Yukawa

Morio Yukawa
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/s/ Frank A. Waring

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